ACROPOLIS®
INVESTMENT MANAGEMENT

PORTFOLIO INSIGHTS

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Acropolis was born from a simple idea:

In an industry where high quality, objective advice is hard to come by, we make a difference by putting the client's interests above our own.

2018's Grizzly Bear Market Growl

Only three months ago, it appeared as though the correction that the S&P 500 suffered in the first quarter was a distant memory.

"This may require some explaining."

But only three days into the fourth quarter, Federal Reserve Chairman Jerome Powell made a speech that rattled investors, because he implied that the Fed was a 'long way' from ending the interest rate hikes that began in 2015. Within a few weeks, the S&P 500 entered its second correction in 2018.

Unlike all of the corrections in the US since the 2008 financial crisis, the one in October was different because market sentiment seemed to change. The FANG index of highflying technology stocks like Amazon, Netflix and Google seemed immune to risk for years, but in the October correction, they fell by -20 percent, double the loss of the S&P 500.

While Chairman Powell was able to alleviate some of the concerns that his speech created, it was too late: markets were unnerved. Many of the risks that investors brushed off previously like valuations, corporate debt levels, the risk of a hard Brexit, and slowing global growth became top of mind concerns. Also, new issues emerged like the flat/partially inverted yield curve and the -37.5 percent drop in WTI oil prices.

While some argue that this isn't a bear market since the S&P 500 is 'only' down -19.8 percent (instead of the classic definition of -20 percent), that's a foolish distinction without a difference: this is a bear market.

The good news at this point is that the economic fundamentals are still in reasonably good shape. Gross Domestic Product (GDP) is forecast to grow at 2.9 percent in 2019, the unemployment rate is very low at 3.7 percent, and inflation is also well under control at just 2.2 percent.

It is impossible to say where stocks will go from here, but we have prepared for this through your strategic asset allocation. We never know when bear markets will occur, but we prepare by making sure that your financial plan can weather bear markets when they arrive.

"Never let the fear of striking out get in your way."
- Babe Ruth, Ballplayer

Stock Market Summary

By Tim Side

It was a tough quarter for stocks as the US equity markets pared gains for the year and along with international markets, finished the year at a loss with an increase in volatility.

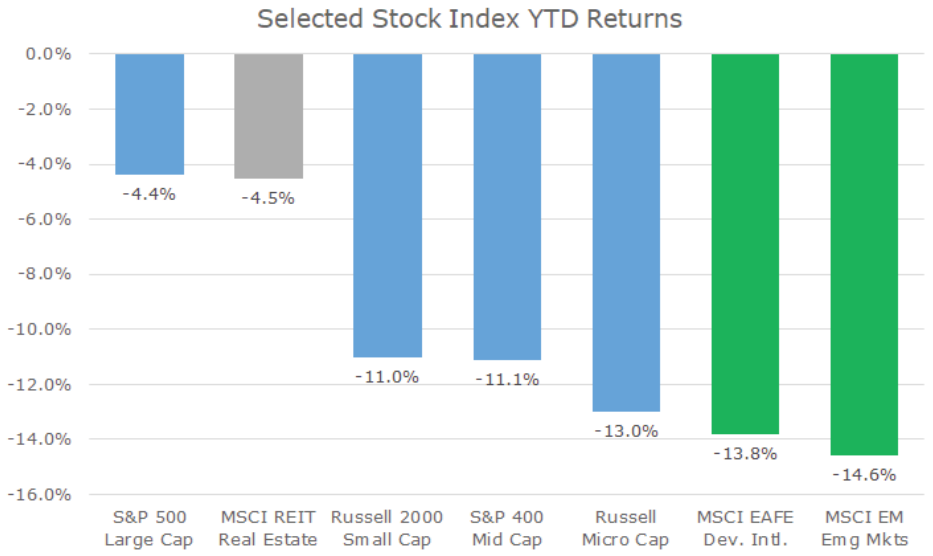
The S&P 500 Index's performance was right in the middle of all major asset classes for the fourth quarter, falling 15.0 percent for the quarter but finishing as the best relative performing asset class for the year, down 4.4 percent.

The health care, utilities, and consumer discretionary sectors were the only sectors to finish the year with a gain, up 6.5 percent, 4.11 percent, and 0.82 percent respectively. Tech stocks were among the worst performers for the quarter as the tech sector fell 20.9 percent to finish the year down 0.29 percent.

Relatively speaking, developed international and emerging markets were two of the best-performing equity asset classes for the quarter, down 12.4 percent and 6.9 percent respectively, although they finished as the worst performers for the year down 13.8 percent and 14.6 percent.

Sliding oil prices were one of the primary catalysts for the decline in stocks as the price per barrel of WTI oil fell from a high of 76.4 dollars on October 3rd to a low of 42.5 dollars on December 24th, a decline of almost 45 percent. This was largely attributed to surprise waivers for sanctions from the US on Iran, since markets expected sanctions to tighten supply further. Despite an OPEC meeting in November that resulted in more supply cuts, oil continued to fall on fears of over-supply.

The markets also sold off on fears of slowing economic growth due to lower demand and tariffs along with tightening monetary policy as the Federal Reserve raised rates by 25 basis points in December and continued to forecast additional rate hikes in 2019.



Data Source: Bloomberg

Bond Market Review

By Ryan Craft, CFA

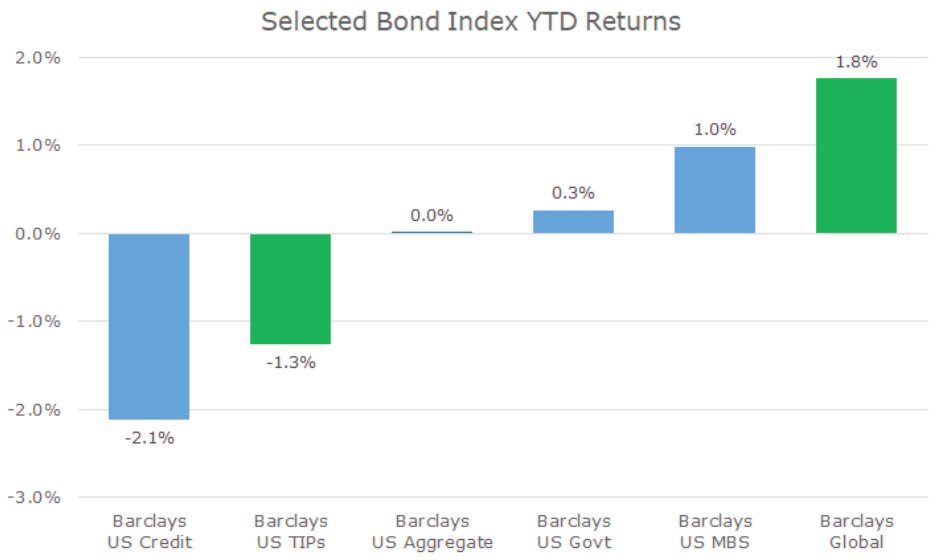
How quickly things change. For the first three quarters of 2018, interest rates did nothing but go up as inflation expectations increased, economic production was booming, and the Fed continued to tighten monetary policy. Then November happened.

The last few months of the year saw a complete repricing of risk and interest rate expectations. Stocks, junk bonds, and even lower investment grade corporate bonds all showed varying signs of distress over the past quarter as the market priced in a higher expected return as compensation for the perceived increase in risk.

On September 30th, the yield curve was very steep, meaning that long-term rates were higher than short-term rates. This is typical in a growing environment where lenders expect a higher return for the higher risk of lending long-term and expectations are for interest rates to be higher in the future. The markets expected the Federal Reserve to continue with its quarterly rate hikes.

Today, everything is different. The yield curve is kinked, with the yield on the 1yr bond, higher than the yields on intermediate-term bonds. In fact, the 1yr yield matches the 10 yr bond yield, which means that the market believes that rates will fall over the coming years. The only way investors would accept a lower yield for a 2yr bond than a 1yr bond is if that investor believes yields will be lower one year from now. The Fed Funds futures market has also abruptly changed and is priced to expect a nearly zero percent chance of the Fed raising rates.

My prior research shows that periods where the 10yr-1yr yield spread is flat/negative are predictive of periods of economic weakness and poor returns for risky asset classes. Today the yield curve is signaling that tough times may lie ahead.



Data Source: Bloomberg

"Change is inevitable. Change is constant."
- Benjamin Disraeli, Former British Prime Minister

"I was taught that the way of progress was neither swift nor easy."
- Marie Curie,
Physicist & First Female Nobel Prize Winner

At Least We Didn't Do Alternatives

By David Ott

Last year was tough for traditional investors like us, but it was just as bad, or even worse, for investors who diversified into alternative strategies.

Alternative investments are difficult to define because we think of them as strategies or assets that aren't stocks and bonds, which means that the universe is large and diverse. Alternatives can also be stocks and bonds, but with an unusual feature like illiquidity, leverage or shorting.

Alternatives are so difficult to define that Morningstar has ten subcategories of funds in their alternative category. And, Morningstar is the first to tell you that the categories don't do a great job of capturing the wide variety of strategies within each category.

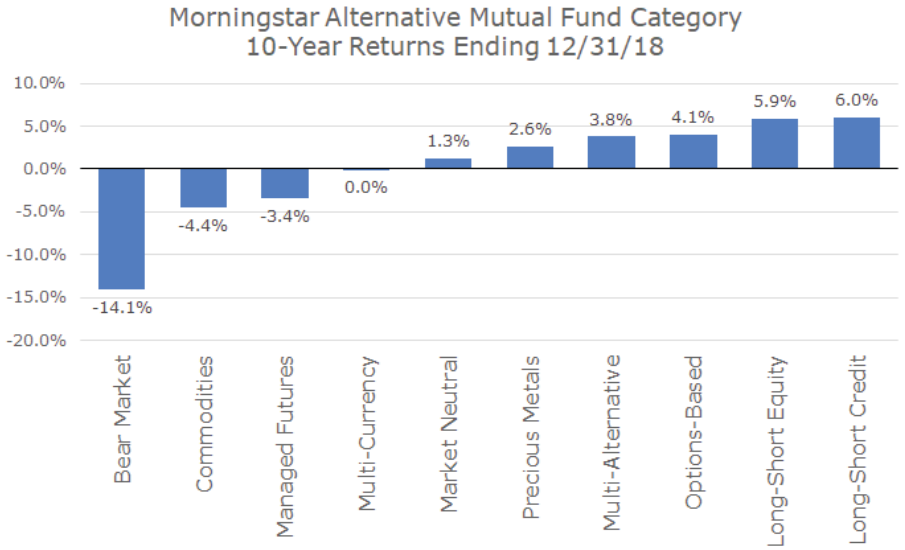
The proliferation of alternative mutual funds and exchange traded funds (ETFs) over the last 10 years is nothing short of remarkable. Back then, while the crisis was fresh in everyone's mind, people thought stock and bond returns were going to be lousy, and investors were going to need a third way.

Naturally, we started looking into them to see if they made sense. I also bought a lot in my account, which often serves as an incubator for investment ideas since you pay very close attention when your own money is on the line.

The chart below shows the returns for each Morningstar category for the 10-years ending in December, and you can see that, for the most part, returns were ho-hum at best.

Over that period, the S&P 500 earned 13.1 percent, the MSCI All Country World exUS made 6.6 percent and the Barclays Aggregate bond index gained 3.5 percent.

Although some of the category returns aren't bad, more than half of them earned less than bonds,



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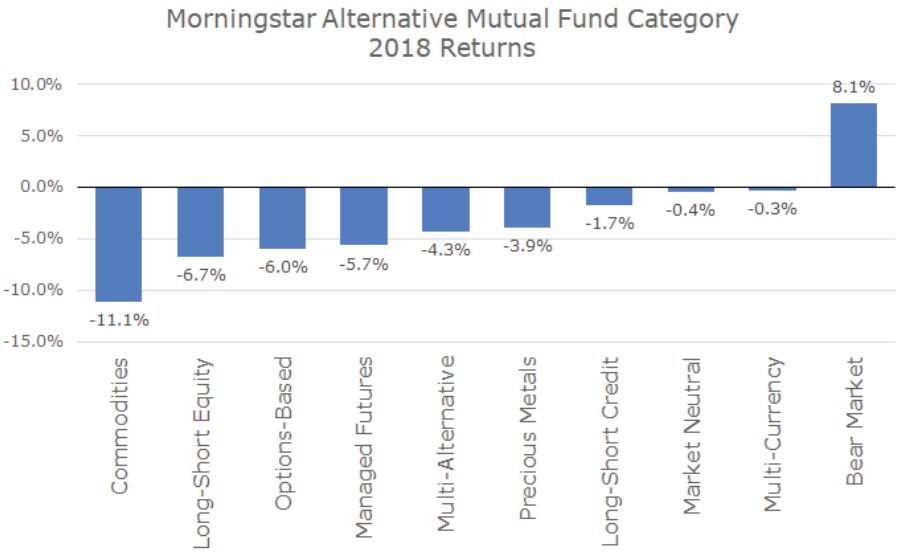


and none of them fared as well as foreign stocks, which we've all been frustrated by given their performance versus the S&P 500.

We concluded a few years ago that alternatives weren't for us, and I am especially happy about that given what happened last year, since I am convinced that people's expectations for alternatives are to make money when stocks and bonds aren't.

In reality, the responsible argument for alternatives is that they aren't correlated with stocks or bonds, except for the Bear Market category, which is explicitly negatively correlated.

Most people hear that and don't recognize the difference between uncorrelated and negatively correlated.

It's pretty simple though if you think about it like this: if an asset is negatively correlated and I tell you that stocks are up, you know that the asset is down (and vice versa). If an asset is uncorrelated and I tell you that stocks are up, you have no idea what the asset is doing: it could be up, down or even.

In the fourth quarter of last year, when the S&P 500 fell -13.5 percent, all of the alternative categories fell except for multi-currency (0.7 percent), precious metals (6.8 percent), and bear market funds (23.9 percent).

I am convinced that investors would have viewed the lousy fourth quarter (and 2018) returns for alternative as adding insult to injury: after mediocre returns for a decade, a lot of people were expecting the alternatives to make money in a downturn and, for the most part, they didn't.

I'm not saying that alternative investments are inherently bad; I still own a bunch (and lost plenty on them). But, they are difficult to own, especially when they lose money while everything else is too.

"Champions keep playing until they get it right."
- Billie Jean King, Tennis Champion

Yield Curve Inversion

By David Ott

"Luck never made a wise man."

- Seneca the Elder, Roman Rhetorician

In early December, the phrase 'inverted yield curve' exploded from the confines of a trading room to the everyday world.

It hit me when I went to a holiday cocktail party after work one night, and someone said, 'Oh, I heard that the stock market is down because something else is upside down. I guess the whole world is upside down!'

The yield curve (or simply 'the curve') plots the yield on bonds with different time horizons.

A normal yield curve is upward sloping, meaning that the yields get higher as the maturity of the bond goes further out in the future. A good representation of a 'normal' curve is pictured below, from one year ago (in gray).

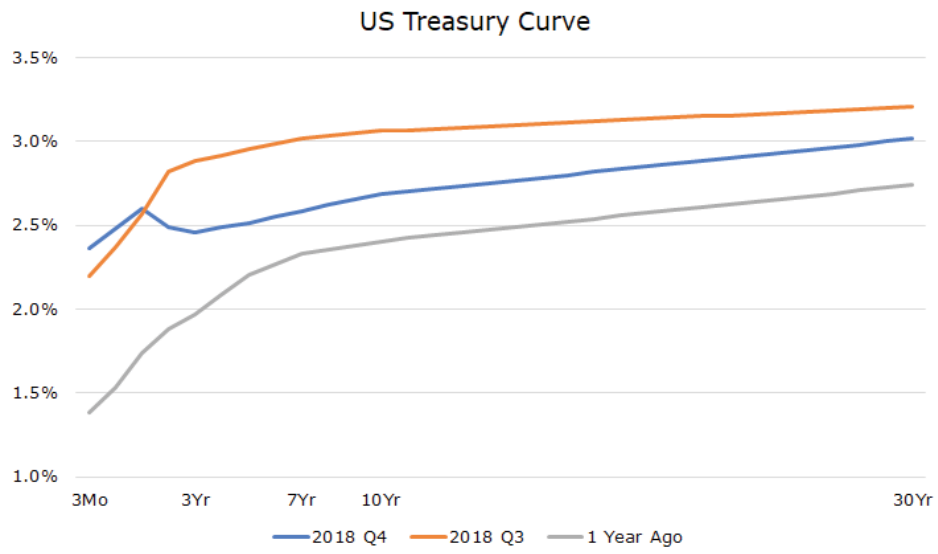
It's intuitive that a long-term bond is riskier than a short-term bond because there is more potential for change in 30-years than in three months, especially for inflation, which hurts bonds. The higher yield is compensation for risk-taking.

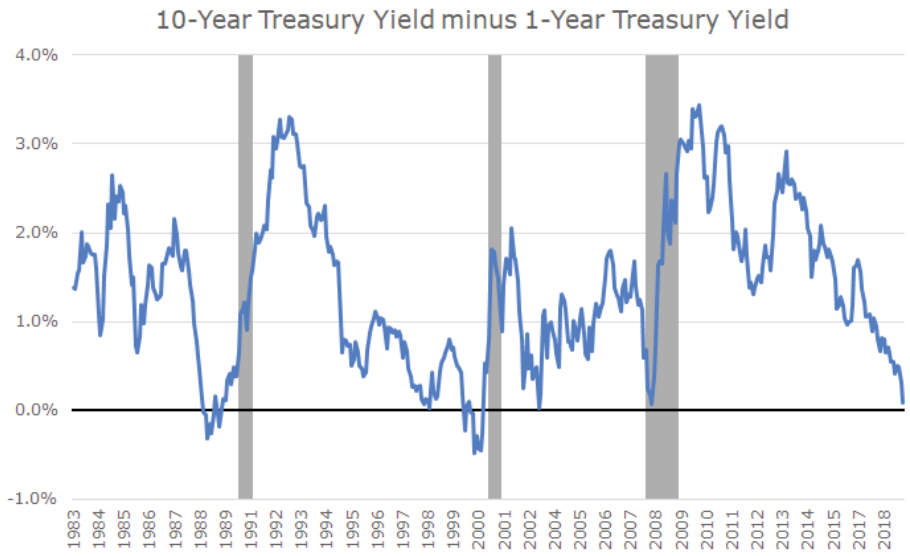
Occasionally, the curve 'inverts,' which means that the yield on short-term bonds is higher than the yield on long-term bonds.

The curve inverts for a few reasons, and none of them are great. The curve could invert, for example, if investors believe that long-term rates will fall, which is usually the result of an economic slowdown or recession.

Economists and investors are particularly mindful of the shape of the yield curve because since 1970 an inverted curve has foretold a recession. The image on the opposite page shows the difference between the 10-Year Treasury note and the 1-Year Treasury bill in blue. The shaded areas represent recessions.

At some points, the difference is very wide, more than three percentage points. The curve is





said to be steep during those periods. You can see that just before the first two recessions, the difference is negative, which means that the curve is inverted. You can see that it almost became inverted just before the 2008 crisis, but not quite.

You can also see what's sparked everyone's interest - that the current difference is minuscule. The chart on the opposite page shows the same yield curve at three different times: a year ago in gray, three months ago in orange and at the end of the year in blue.

As noted earlier, the curve was normal a year ago and was pretty normal at the end of the third quarter. As Ryan noted in his article on page three, a lot happened in the third quarter, and now the curve is kinked: the yield on the one-year Treasury is higher than the seven-year and just short of the 10-year (which would be inverted).

While the chart above does generate some anxiety, I think it's useful to note that this is hardly a perfect indicator, especially regarding timing.

Note how the curve became quite inverted in early 1989, but the recession didn't happen until mid-1990. The same occurred with the second recession - the curve inverted in March 2000 and the recession didn't start for another year. The curve also reached the same level of inversion as today in 2003, and there was no subsequent recession.

I'm not trying to downplay the importance of the state of the curve right now - I think it's a big deal. I am only trying to say that we shouldn't infer too much about the timing of a recession from this data.

I believe that this is a time for caution, but I'd bet that anyone watching the stock market would already say the same thing.

"Money is the root of all evil, and yet it is such a useful root that we cannot get on without it any more than we can without potatoes"
- Louisa May Alcott, Author

Data Center	2018
Dow Jones	-3.48%
S&P 500	-4.39%
S&P Midcap	-11.10%
Russell 2000	-11.03%
MSCI EAFE (Intl)	-13.79%
MSCI Emerging Mkt	-14.58%

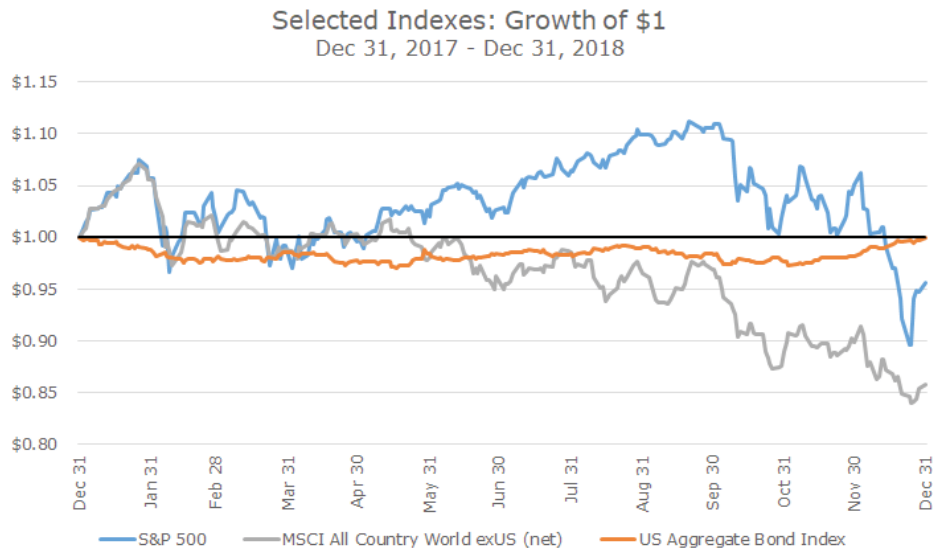
S&P Sectors	2018
Basic Materials	-14.70%
Consumer Discretion.	0.82%
Consumer Staples	-8.39%
Energy	-18.10%
Financials	-13.04%
Healthcare	6.47%
Industrials	-13.32%
REITs	-2.23%
Technology	0.29%
Communications	-12.53%
Utilities	4.11%

Interest Rates	Q4 2018
Fed Funds	2.50%
Prime Rate	5.50%
3-mo. Treasuries	2.36%
2-yr. Treasuries	2.49%
5-yr. Treasuries	2.51%
10-yr. Treasuries	2.69%

Currencies	Q4 2018
Euro	1.1467
Japanese Yen	109.69
British Pound	1.2754

All Data as of 12/31/2018

The Big Picture



Fast Facts: Education & Finances Edition

$25,097 The highest net price (tuition, room & board, discounts, etc.) for a public college, the Colorado School of Mines. The national average is $12,272. The highest net price for private school is $50,472 for the California Institute for the Arts. The national average is $21,778.

$520 The median weekly earnings for those with less than a high school diploma. A bachelor's degree gets a raise to a median wage of $1,173 per week, and a professional degree earns a median wage of $1,836 per week.

$1.5 Trillion The total amount of student debt outstanding in 2018 across 44 million borrowers, according to Student Debt Hero, a student loan counseling firm. The class of 2018 will graduate with an average debt balance of $39,400.

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